***United States Court of Appeals***

***for the Second Circuit***


# REPLY BRIEF

# 74-1680

ORIGINAL

In The

## United States Court of Appeals

For The Second Circuit

SECURITIES AND EXCHANGE COMMISSION,

*Plaintiff-Respondent,*

*vs.*

MANAGEMENT DYNAMICS, INC., EDWIN BARRETT, CLYDE GOFF, EPHRAIM HOFFMAN, PETER R. WATSON, GLOBAL SECURITIES, INC., ALLEN LANGENAUER, DAVID LANGENAUER, BERNARD OSCHERS, LEE SCHNEIDER, JOSEPH CIRELLO, FAIRFIELD SECURITIES, INC., THOMAS F. BRENNAN, III,

*Defendants.*

and

WILLIAM N. LEVY, A.J. CARNO, INC., ANTHONY NADINO, MAYFLOWER SECURITIES, INC. and SAMUEL D. HODGE,

*Defendants-Appellants.*



# REPLY BRIEF OF APPELLANTS-DEFENDANTS, A. J. CARNO, INC. and ANTHONY NADINO

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REPLY BRIEF OF APPELLANTS-DEFENDANTS,
A. J. CARNO, INC. and ANTHONY NADINO

## PRELIMINARY STATEMENT

Appellants, A. J. CARNO, INC. ("Carno") and ANTHONY NADINO ("Nadino") submit this Reply Brief regarding their appeal from the Order of Judge Robert L. Carter preliminarily enjoining them from violating Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder in connection with the stock of Management Dynamics "or any other security."

The most significant reference the District Court made to the allegedly unlawful activities of Carno and Nadino is the following statement:

> "Nadino is Vice-President of A. J. Carno, Inc. He has been employed by Carno since June, 1971 and assumed charge of Carno's trading in September, 1972. He began Carno trading in MD shares in June, 1971, but at the time he knew nothing about MD. He made no inquiry of the SEC to determine whether MD shares were registered, and quotations submitted on Pink Sheets by Carno were based solely on the market for MD shares. The August and October letters, the October Press Release, data in National Stock Summary from April, 1970, to March, 1971, and an interoffice memorandum of November 28, 19721 of Filor Bullard & Smythe constituted Carno's total information on MD. Between September 28, 1972 and November 15, 1972 Carno purchased 11,226 MD shares in the over-the-counter market and 9,825 of these were sold to Global." (125).*

Judge Carter recognized that Mr. Nadino began trading Management Dynamics' stock in May or June, 1971. His interest in Management Dynamics' stock was stimulated by the quiet state of the stock market at that time. Brokerage firms were closing. Carno could only afford to give Nadino a limited amount of money for trading, and Managment Dynamics was a low priced stock that fit well within Nadino's allotment. (Nadino Tr. 349).

Before making his first transaction in Managment Dynamics' stock in June 1971, Mr. Nadino made a searching inquiry to determine whether Management Dynamics had previously traded. Mr. Nadino checked the National Stock Summary and found that not only had Management Dynamics' stock been listed

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* Parenthesis refers to the Joint Appendix

as far back as 1970, but other well known brokerage firms had been trading Management Dynamics' stock for well over a year.

At the evidentiary hearing, Mr. Nadino produced copies of the quotations of Management Dynamics' stock which appeared in the National Stock Summary, which was marked Exhibit 13. (Nadino Tr. 348-349). The first part of Exhibit 13 discloses that twelve reputable brokerage firms had been submitting bid and ask quotations for Managment Dynamics' stock for as far back as April 1970:

| Date | Bid | Asked | Brokerage Firm |
|---|---|---|---|
| 4/17/70 | 3 | 3 1/2 | Economic Planning Corp. |
| 5/6/70 | 2 | 2 3/4 | Leonard Bros. Inc. |
| 5/14/70 | 3/4 | 1 1/2 | Packer Wilbur & Co. Inc. |
| 6/2/70 | 1 | 2 | Welger & Co., Inc. |
| 8/20/70 | 1 1/4 | 1 3/4 | F.S. Donahue Santo & Co. |
| 9/23/70 | 1 | 2 | E.L. Aaron & Co., Inc. |
| 9/23/70 | 1/2 | 1 1/4 | Edward F. Henderson & Co. |
| 9/29/70 | 3/4 | 1 1/4 | Mandelbaum Secs Corp. |
| 10/12/70 | -0- | 5/8 | David E. Brill Co. |
| 10/14/70 | 3/8 | -0- | Advest Co. |
| 11/3/70 | 1 1/16 | 1 3/4 | E.L. Aaron & Co., Inc. |
| 1/21/71 | 1 1/4 | 1 3/4 | Edward F. Henderson & Co. |
| 3/1/71 | 3/4 | 1 1/4 | Mandelbaum Secs Corp. |
| 3/31/71 | 3/4 | 1 1/2 | Bertner Bros. |
| 3/31/71 | 7/8 | -0- | E. W. Smith Co. |

Mr. Nadino also produced a schedule reflecting his trading in Management Dynamics stock from June 9, 1971 to December 31, 1971. This schedule had already been annexed as Exhibit A to Mr. Nadino's affidavit in opposition to the SEC's motion for the preliminary injunction (50), and was received in evidence as Exhibit A-2 during the evidentiary hearing. (Nadino Tr. 345).

An examination of Exhibit A-2 reveals that all of Mr. Nadino's trades in Management Dynamics stock during 1971 were with seventeen responsible brokerage firms, who had no relationship to Management Dynamics. Most of the brokerage firms were members of the New York Stock Exchange and American Stock Exchange, and all were simply interested in making profits by trading Management Dynamics stock. Thus, Exhibit A-2 discloses that Mr. Nadino was buying and selling Management Dynamics stock with reputable brokerage firms throughout 1971:

| Date of Purchase | Date of Sale | No of Shares | Brokerage Firm |
|---|---|---|---|
| 6/9/71 | | 200 | Herzog & Company |
| | 6/21/71 | 200 | Provident Securities |
| | 6/21/71 | 200 | Delphi Capital |
| | 6/21/71 | 200 | Hornblower Weeks |
| 6/23/71 | | 200 | Ken Marshal & Co. |
| | 6/23/71 | 200 | Raffels & Co. |
| | 6/25/71 | 100 | Estabrook & Co. |
| | 6/28/71 | 300 | Bache & Co. |
| | 6/28/71 | 300 | Delphi Capital |
| | 7/1/71 | 100 | Herzog & Company |

| | | | |
|---|---|---|---|
| 7/6/71 | | 100 | Herzog & Company |
| | 7/6/71 | 200 | Hornblower Weeks |
| | 7/16/71 | 200 | Delphi Capital |
| 7/20/71 | | 200 | Bache & Co. |
| | 7/22/71 | 200 | Bertner Brothers, Inc. |
| 7/23/71 | | 500 | Thomas & McKinnon |
| 7/27/71 | | 107 | Bache & Co. |
| 7/28/71 | | 200 | Selheimer & Co. |
| 7/29/71 | | 300 | Estabrook & Co. |
| 8/24/71 | | 100 | Delphi Capital |
| 9/21/71 | | 7 | Merrill Lynch |
| 10/21/71 | | 650 | Eastman Dillon |
| 10/27/71 | | 1000 | Eastman Dillon |
| | 11/3/71 | 1100 | Ken Marshall & Co. |
| | 11/10/71 | 1100 | Ken Marshall & Co. |
| 11/11/71 | | 501 | Herzog & Company |
| 11/16/71 | | 700 | Raffel & Co. |
| | 11/19/71 | 1100 | Friedman Mangor & Co. |
| 11/22/71 | | 4000 | Eastman Dillon |
| | 11/23/71 | 554 | Bache & Co. |
| | 11/23/71 | 200 | Butcher & Sherrerd |
| | 12/14/71 | 300 | Elkins Morris & Co. |
| | 12/14/71 | 200 | Elkins Morris & Co. |
| | 12/31/71 | 1100 | Friedman & Co. |

By the end of 1971, approximately thirty brokerage firms had already purchased and sold Management Dynamics stock. As shown in the second part of Exhibit 13, six additional brokerage firms submitted bid and ask quotations in Management Dynamics stock by September 29, 1972 - the date Mayflower Securities submitted its first quote to the National Stock Summary:

| Date | Bid | Asked | Brokerage Firm |
|---|---|---|---|
| 4/18/72 | 1/8 | 5/8 | R. Basile & Co Inc |
| 4/27/71 | 1/2 | | Frost, Johnson R & S |
| 5/1/71 | 1/2 | | Richard Alyn & Co |
| 5/12/72 | 1/2 | | Friedman Mngr & Co. |
| 6/28/72 | 3/8 | 5/8 | E. L. Aaron & Co Inc |
| 7/10/72 | 5/16 | | Carlton Cambridge & Co. |
| 9/19/72 | 2 5/8 | | Walter C. Krugs & Co. |
| 9/22/72 | 2 1/4 | 3 | Dopler & Co Inc |
| 9/29/72 | 2 1/2 | 3 1/4 | A. J. Carno Co Inc |
| 9/29/72 | 2 1/4 | 3 1/2 | Mayflower Secs Co |
| 9/29/72 | 2 1/2 | 3 | Peripheral Systems Inc |

These exhibits manifest that Management Dynamics had been a widely traded security by responsible brokerage firms for well over two years before Mayflower Securities or Global Securities submitted their <u>first</u> bid or ask quotation for Management Dynamics stock. In these circumstances, Mr. Nadino had good reason to believe that he could freely trade Management Dynamics stock in the over-the-counter markets.

## CARNO AND NADINO'S POSITION

In view of Management Dynamic's history of trading in the over-the-counter markets, Carno and Nadino respectfully submit that the District Court was not justified in concluding that

> "...the conduct of Carno...and Nadino... in trading and quoting MD shares at prices not related to the activities of the company is also violative of the anti-fraud provisions of the Securities Act. The record established that artifically high prices were maintained; that the bulk of the shares purchased went to Global and that Brennan was assured 1/8 point profit on all shares acquired from Global. What was done here constituted fictitious quotations and manipulation of MD shares. See Franklin National Bank v. L. B. Meadows & Co., 318 F.Supp. 1339 (E.D.N.Y. 1970)." (128).

## ARGUMENT

### POINT I

### THE DISTRICT COURT ERRED IN FINDING THAT THE PRICES AT WHICH CARNO AND NADINO QUOTED THE SHARES OF MANAGEMENT DYNAMICS' STOCK SHOULD BE RELATED TO THE BUSINESS OF THAT COMPANY.

The District Court's opinion concluded that the conduct of Carno and Nadino in trading and quoting Management Dynamics stock "at prices not relating to the activities of the company was violative of the anti-fraud provisions of the Securities Act." (128). Ostensibly, the District Court envisions the over-the-counter market as a place where the

price of a security is determined solely by the financial position of the corporation. This view is clearly contrary to the experience and practices of the securities industry.

The securities industry has long recognized that the value of a security is predicated solely upon the price a buyer is willing to pay for it or a seller is willing to take for it at the time of sale. Prices are arrived at by dealers negotiating with other dealers in order to arrive at the best price.[1] Thus, the prevailing practice of securities traders and/or specialists is to emphasize the supply and demand for the security rather than the financial activities of the company in determining the bid and ask quotations for the stock.[2]

The validity of determining the concept that the price of a security is determined by the law of supply and demand is reflected in the House Report on the Exchange Act, H.R.Rep. No. 1383, 73d Cong., 2d Sess.(1934), in which it is stated at page 11 thereof:

> "Legitimate investors desire to buy at as low a price as possible and to sell at as high a price as possible, and honest markets are made by the balancing of investment demand and investment supply." (Emphasis added)

As long ago as 1938, the courts recognized that the price of a security is based on the law of supply and demand. In SEC v. Torr, 22F.Supp.602,607 (S.D.N.Y., 1938), Judge Woolsey

1. See, e.g., NASD Training Guide, published by the National Association of Securities Dealers, Inc., 1971, page 41.
2. See, e.g., Willett, Fundamentals of Securities Markets, Appelton Century Crofts, 1968, page 135; Browne, You Can Profit From A Monetary Crisis, MacMillan Publishing Co., Inc., 1974, pages 16 and 21; Loeb, The Battle for Stock Market Profits, Simon and Schuster, 1971, pages 37,78 and 83.

stated:

> "I do not think there could be any dispute about the fact - indeed I suppose it is very trite to mention it - that the true value of a security is the price which it commands when it achieves its equilibrium in a free market. I think this is so obvious that all men can properly agree on it." (Emphasis added).

Unfortunately, Judge Carter did not agree that the price of Management Dynamics stock reflected its equilibrium in the free market. Instead, Judge Carter mistakenly believed that the price of Management Dynamics stock was the result of fictitious quotations and manipulations by Carno and Nadino.

In his opinion, Judge Carter cited Franklin National Bank v. L. B. Meadows & Co., 318 F.Supp. 1339 (E.D.N.Y. 1970), to support the conclusion that "what was done here constituted fictitious quotations and manipulation of Management Dynamics shares." (128). A careful reading of Franklin National Bank v. L. B. Meadows & Co. will reveal that the case is wholely distinguishable in law and fact from the one at bar.

In Franklin National Bank v. L.B. Meadows & Co., the plaintiff sought damages arising from defendants alleged violation of Section 15(c)(2) of the Securities Exchange Act of 1934. The violation was allegedly committed by four broker-dealers who created a false market in a security by

submitting fictitious quotations to the National Quotation Bureau for listing in its Pink Sheets. The fictitious quotations were intended to create the appearance of a market in the stock so that Franklin National Bank would be induced to make a substantial loan to one of the defendants after relying upon the fictitious quotations to establish value for the securities posted as collateral. Defendants moved for summary judgment upon the grounds plaintiff had allegedly had no private right of action for a violation of Section 15(c). Judge Weinstein denied defendants' application since there is a private right of action under this section and material issues of fact existed.

It is clear that the conduct of Carno and Nadino is worlds apart from the conduct of the broker-dealers who were defendants in Franklin National Bank v. L. B. Meadows & Co. Carno and Nadino were clearly making bona fide quotations, as were approximately thirty other responsible brokers, in a widely-traded stock in the over-the-counter markets.

Not only are the facts regarding Carno and Nadino's activities entirely distinguishable than those involving the brokers named as defendants in Franklin National Bank v. L. B. Meadows & Co., but the alleged violations against Carno and Nadino are also entirely different. In Franklin National Bank, the plaintiff's cause of action was based upon the

violation of Section 15(c)(2). On the other hand, Carno and Nadino have not even been charged with violations of Section 15(c)(2). Consequently, Judge Carter's reliance upon Franklin National Bank v. L.B. Meadows & Co.was entirely misplaced.

It is important to note that Carno and Nadino emphatically deny the accusation that they submitted fictitious quotations. Indeed, approximately thirty reputable brokerage firms including Bache, Merrill Lynch, Hornblower Weeks and Thomson & McKinnon were the buyers and sellers of Management Dynamics stock purchased and sold by Carno and Nadino. A careful analysis of the trading done by Carno and Nadino reflects that all they did was participate in an orderly market along with thirty other brokerage firms. Thus, the District Court's conclusion that Carno and Nadino submitted fictitious quotations is clearly erroneous and the order of preliminary injunction should be vacated.

## POINT II

### THE DISTRICT COURT ERRED IN CONCLUDING THAT THERE WERE VIOLATIONS OF SEC RULE 15c2-11 UNDER THE SECURITIES EXCHANGE ACT OF 1934.

The District Court concluded that Carno and Nadino violated SEC Rule 15c2-11 for publishing quotations regarding Management Dynamics without having "information concerning the nature of the issuer's business, the nature and extent of the issuer's facilities and financial information for at least two preceding year." (128-129).

As noted above, Carno and Nadino were not charged with violating Rule 15c2-11. During the evidentiary hearing, this fact was noted on the record. (Nadino, Tr. 341). However, even if we assume, arguendo, that a violation of Rule 15c2-11 was alleged, Carno and Nadino's trading activities fall within an exception to the rule.

Rule 15c2-11 requires that market makers have in their files certain enumerated information prior to inserting quotes in an inter-dealer quotation system. While there was never a showing that Carno and Nadino did not have the requisite information, the rule states at paragraph (f) as follows:

> (3) the publication or submission of a quotation respecting a security which has been the subject of both bid and ask quotations in an inter-dealer quotation system at specified prices on each of at least twelve days within the previous thirty calendar days, with no more than four business days in succession without such a two-way quotation.

According to the findings of the District Court, and the exhibits introduced during the hearing and reproduced above, approximately thirty responsible brokerage firms had been submitting numerous bid and ask quotations to the National Stock Summary for well over two years before September, 1972, i.e., the date on which the allegedly improper activity began. It is, therefore, apparent that the express language of the rule itself does not require Carno and Nadino to comply with

the provisions of Rule 15c2-11. Thus, the District Court's conclusion that a violation of Rule 15c2-11 occurred is clearly erroneous, and the order of preliminary injunction should be vacated.

## POINT III

### THE DISTRICT COURT ERRED BY FAILING TO FIND THE FACTS SPECIFICALLY AND STATE SEPARATELY ITS CONCLUSIONS OF LAW THEREON.

In granting or refusing interlocutory injunctions, the District Court is required to set forth the findings of fact and conclusions of law which constitute the grounds of its decision. FRCP 52(a).

The Supreme Court has ruled that it is of "the highest importance" to a review of an order granting or refusing a preliminary injunction that there should be "fair compliance" with Rule 52(a) of the Federal Rules of Civil Procedure. Mayo v. Lakeland Highland Canning Co., Inc., 309 U.S. 310, 316 (1940). Thus, a failure by the District Court to find the facts specifically and state separately its conclusions of law thereon justifies vacating the order of preliminary injunction. SEC v. Frank, 388 F.2d 485 (2d Cir., 1968); Dopp v. Franklin National Bank, 461 F.2d 873 (2d Cir., 1972); United States v. Forness, 125 F.2d 928 (2d Cir., 1942); Nickerson v. Travelers Insurance Company, 437 F.2d 113 (5th Cir., 1971); Davis v. United States, 422 F2d 1139 (5th Cir., 1970).

The purpose of Rule 52(a) is satisfied if the trial court's findings are sufficient to afford a clear understanding of the ground upon which the court based its judgment. SEC v. Frank, supra; Dopp v. Frankling National Bank, supra; United States v. Forness, supra; Fluor Corp. v. United States ex rel. Mosher Steel Co., 405 F.2d 823 (9th Cir.,1969); Gulf King Shrimp Co. v. Wertz, 407 F 2d 508 (5th Cir.,1969).

A fair reading of the District Court's opinion reveals that the findings of fact are insufficient to form a basis for the decision and are not adequately supported by the evidence. Thus, the absence of findings of fact with respect to the following pivotal issues demonstrates that the reasons underlying the decision to preliminarily enjoin Carno and Nadino are not sufficient to satisfy Rule 52(a):

1. The District Court concluded that Carno and Nadino submitted fictitious quotations in Management Dynamics stock in violation of Rule 15c2-11. If the District Court attempted to articulate findings of fact to support this conclusion, it would have realized that

    (a) the quotations were not fictitious since approximately thirty brokerage firms had been trading Management Dynamics stock for over two years;

    (b) Carno and Nadino were not even charged with violating Rule 15c2-11; and

    (c) the record facts would be inadequate to support a finding that a violation of Rule 15c2-11 occurred.

2. The District Court concluded that Carno and Nadino violated the anti-fraud provisions in connection with the dissemination of the August and October communications. If findings were stated, the District Court would have realized that Carno and Nadino had nothing to do with the preparation of the documents.

3. The District Court concluded that Carno and Nadino violated Section 5 of the Securities Act. If an attempt was made to state reasons to support this conclusion, the District Court would have been forced to realize the applicability of the dealers' exemption and the brokers' exemption in these circumstances.

4. The District Court concluded that the SEC demonstrated " a need" for the preliminary injunction. Not only did the District Court employ an improper standard for granting the preliminary injunction, but it also would have realized that, in view of the suspension of trading and other variables, there really was not a need for the preliminary injunction since it was extremely unlikely that other violations of the securities laws would be committed.

The absence of findings regarding these hearthstone issues raise the gravest doubt as to what the District Court thought the fact to be. For this reason alone, the failure to separately state findings of fact from conclusions of law constitutes reversible error. SEC v. Frank, supra; Dopp v. Franklin National Bank, supra; United States v. Forness, supra; Nickerson v. Travelers Insurance Company, supra; Davis v. United States, supra.

## POINT IV

## THE DISTRICT COURT ERRED IN FAILING TO RECOGNIZE THE EXISTENCE OF EXEMPTIONS FROM THE SECURITIES ACT

The SEC alleged that Carno and Nadino violated Sections 5(a) and 5(c) of the Securities Act of 1933 by offering for sale and selling unregistered stock. In their answer to the complaint, Carno and Nadino interposed affirmative defenses based upon the transactional exemptions from the registration requirements of Section 5. (19). These affirmative defenses were also interposed in the affidavits in opposition to the SEC's motion for a preliminary injunction by Mr. Nadino and Robert Berkson, president of Carno. (42-50). Unfortunately, Judge Carter did not even broach the issues relating to the availability of these exemptions.

### A. Dealer's Exemptions

Section 4(3) of the Securities Act of 1933 exempts from the registration provisions of Section 5 transactions by a "dealer". Although there are three limitations to the dealer's exemption none of the limitations apply in these circumstances.

Section 2(12) of the Securities Act defines a dealer as being

"Any person who engages either for all or part of the time, directly or indirectly, as agent, broker or principal, in the business of offering, buying, selling or otherwise dealing and trading in the securities issued by another person."

It is manifest that the express language of Section 2(12) that both Carno and Nadino qualify for a dealer's exemption from the registration provisions according to the express provisions of the statute.

In addition, one of the releases published by the SEC itself further manifests that Carno and Nadino are entitled to a dealer's exemption from the registration provisions. SEC Release No. 33-4445 states that:

"The amount of inquiry called for necessarily varies with the circumstances of particular cases. A dealer who is offered a modest amount of a widely traded security by a responsible customer, whose lack of relationship to the issuer is well known to him, may ordinarily proceed with considerable confidence. On the other hand, when a dealer is offered a substantial block of a little-known security, either by persons who appear reluctant to disclose exactly where the securities came from, or where the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then searching inquiry is called for." (Emphasis added).

In view of the fact that approximately thirty brokerage firms had been offering modest amounts of Management Dynamics stock for well over a year before Nadino submitted his

first bid or asked quotation, and well over two years before either Mayflower Securities or Global Securities first attempted to trade this stock, it is evident that Carno and Nadino were entitled to "proceed with considerable confidence" in buying and selling Management Dynamics stock.

It is important to note that the SEC does not contest the applicability of the dealer's exemption. It merely claims that "the burden of establishing the burden of an exemption from the registration provisions is upon a person claiming an exemption.[3] Carno and Nadino respectfully submit that they have more than satisfied this burden.

By reason of the foregoing, the District Court's conclusion that Carno and Nadino violated the anti-fraud provisions of the Securities Act was clearly erroneous, and the order of preliminary injunction should be vacated.

B. Broker's Exemption

In addition to the dealer's exemption provided by Section 4(3), Section 4(4) exempts from the registration of the registration requirements of Section 5

3 - SEC BRIEF, Page 39.

"brokers transactions executed upon customers' orders upon any exchange or on the over-the-counter market but not the solicitation of such order."

All of Mr. Nadino's trading in Management Dynamics stock was made for Carno's trading account for resale to other brokerage firms except for two unsolicited brokerage transactions executed upon order from one Samuel Hodge.

The SEC did not contest the applicability of a brokers' exemption from the registration provisions for the two unsolicited brokerage transactions Carno executed for Samuel Hodge. All the SEC claimed was that the burden is on Carno and Nadino to establish their right to an exemption.[4]

Mr. Robert Berkson, president of Carno, testified that Mr. Hodge placed two unsolicited sell orders with Carno after Mr. Hodge opened an account with the firm. (Berkson Tr.364). Mr. Berkson further testified that he had several good reasons to believe that Mr. Hodge's shares of Management Dynamics stock were registered and freely transferable.

Firstly, Hodge's stock was received by Carno in proper form. The number of shares involved were of a modest amount, and there was no legend or other marking on the stock certificates to indicate a restriction. Thirdly, Mr. Hodge did not give Mr. Berkson cause to believe that the stock was restricted. (Berkson Tr.365). Finally, the stock sub-

4 - SEC BRIEF, Page 39

sequently cleared through other responsible brokerage firms and the transfer agent. Thus, it is evident that Carno did nothing more than execute two unsolicited brokerage transactions for Samuel Hodge.

By reason of the foregoing, Carno and Nadino respectfully submit that the District Court improvidently granted permanent injunction against them since the brokers' exemption and the dealers' exemption are affirmative defenses against the alleged violations of Section 5 of the Securities Act.

## POINT V

## THE DISTRICT COURT ERRED IN CONCLUDING THAT CARNO OR NADINO AGREED TO SELL THE BULK OF THEIR MANAGEMENT DYNAMICS STOCK TO GLOBAL SECURITIES

The District Court concluded that from September 29, 1972 to December 8, 1972 the "bulk" of the Management Dynamics stock sold by Carno and Nadino was to Global Securities (125 & 128). Although Global did purchase a significant amount of Management Dynamics stock during this isolated period of time, there were a substantial number of other reputable brokerage firms also buying and selling Management Dynamics stock in the over-the-counter market at that time. This fact was overlooked by the District Court as was the fact other brokerage firms were also buying and selling Management Dynamics stock from Carno and Nadino at that time. Consequently, the

mere fact that Global was a large purchaser of Management Dynamics stock during this limited period of times does not justify the conclusion that Carno and Nadino violated the security laws.

The SEC made much ado over the alleged "elistment" of Carno into Global's "scheme" of allegedly inserting "bids for Management Dynamics stock in the National Quotation Bureau's pink sheets, thereby causing a false appearance of interest in the stock in the over-the-counter market".[5]

Carno and Nadino emphatically denies this contention, and stated that there is no evidence in the entire record to support the accusation that Carno or Nadino were "enlisted" by anyone of the defendants for any purpose whatsoever. Indeed, Mr. Berkson and Mr. Nadino specifically refuted this accusation in their answer to the complaint (18), and their affidavits in opposition to the SEC's motion for a preliminary injunction (43 and 48). Furthermore, a careful review of the buying and selling of Management Dynamics stock unequivocally establish Carno and Nadino's independence from the first day they began trading their stock.

Despite Mr. Berkson's and Mr. Nadino's undisputed denials that any sort of agreement existed with respect to Management Dynamics stock, the SEC proceeded to grossly distort the record facts in pursuit of the claimed conspiract to manipulate Management Dynamics stock.[6]

5 - SEC Brief, pages 5-6
6 - SEC Brief, pages 5, 6, 28, 29, 30, 31, 33.

For the reasons set forth below, it is painfully clear that neither Carno nor Nadino was a party to the alleged scheme designed to create "a false appearance of interest in the stock in the over-the-counter market".[7] Consequently, Carno and Nadino cannot be associated with the alleged agreement to alleged bid up the price of Management Dynamics stock from 62.5¢ to $6 per share.[8]

A. No Agreement with Mayflower or Global

There is no evidence in the record to support the SEC's charge that Carno and Nadino were "enlisted" by Global and Mayflower to help them bid up the price of Management Dynamics stock. Nevertheless, the SEC persisted in charging that the quotations submitted by Carno between September 14, 1972 and December 8, 1972 represent a device scheme or artifice that operated as a fraud upon "all members of the public who traded Management Dynamics stock."[9]

Firstly, there is nothing in the entire record to support the bold accusation that Carno engaged in a "course of business" or "a device, scheme or artifice" that operated as a fraud upon the public as the result of their trading the Management Dynamics stock.

7 - SEC Brief, pages 5-6
8 - SEC Brief, pages 6, 28, 29, 30, 31, 33
9 - SEC Brief, page 29

Secondly, the chart submitted by the SEC as evidence of the alleged scheme or artifice to defraud is deceptively misleading since it ignores Carno's good faith history of trading in Management Dynamics stock and obfuscates the fact that approximately thirty other brokerage firms were trading Management Dynamics stock along with Carno.

Finally, the SEC did not even bother to investigate whether Management Dynamics stock had ever traded in the over-the-counter market before it accused Carno and Nadino of participating in the alleged manipulation. Carl Dreyer, the SEC investigator who testified to the alleged manipulation, admitted that he did not check whether Management Dynamics stock traded as far back as June 1971, nor did he check whether Management Dynamics stock had been listed in the pink sheets in June 1971. (Dreyer Tr. 138). Moreover, Mr. Dreyer did not check the books and records of Carno to ascertain whether there had been trading between June 1971 and September of 1972 (Dreyer Tr. 139). Consequently, the limited approach employed by the SEC in its investigatory processes so limited the SEC prospective as to render it incapable to judging the nature or quality of trading by Carno and Nadino in Management Dynamics stock.

B. No Agreement with William Levy

The SEC accused Mr. Robert Berkson, president of Carno, of having met with William Levy four or five times during the Fall of 1972.[10] The clear inference is that Mr. Berkson and Mr. Levy met to discuss a scheme for bidding up the price of Management Dynamics stock for re-sale to Global. The inference would like the Court to draw is totally unfounded, and there is no evidence in the record to support it.

Firstly, the SEC's claim that there were four or five meetings between Mr. Berkson and Mr. Levy is false and untrue. The record merely reflects the fact that some time in September or October, 1972, Edward Barrett (President of Management Dynamics), William Levy and Pauline Kirschenbaum (an account executive with the firm of Adams & Peck) came into Mr. Berkson's office unannounced and unexpected. (Berkson Tr. 357). At that time, Mr. Berkson's office was at 80 Broad Street, New York City and the Trading Department of Carno was at 42 Broadway.

During the meeting, Mr. Levy indicated that he wanted to introduce the new management of Management Dynamics and to say "hello" (Berkson, Tr. 357). Mr. Levy had a folder

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10 - SEC Brief, page 34 footnote 26.

with him which he gave to Mr. Berkson containing documents which were incorporated as part of Carno's due diligence file (Berkson, Tr. 358).

Although Mr. Berkson received three to five telephone calls from Mr. Levy subsequent to that meeting, the calls simply were inquiries into the price at which Management Dynamics' stock was trading. Most importantly, nothing was ever discussed with respect to an alleged agreement between Mr. Levy and Mr. Berkson with respect to the trading of Management Dynamics' stock, and the record so reflects (Berkson Tr. 359). Thus, the SEC's transparent attempt to create the inference that Mr. Berkson conspired with Mr. Levy to bid up the price of Management Dynamics stock is so patently without merit as not to be deserving of further consideration.

C. No Agreement with Samuel Hodge

There is no merit to the SEC's contention that Carno's "acceptance" of two orders from Samuel Hodge to sell shares of Management Dynamics stock means that Carno participated in Management Dynamics stock.[11]

Samuel Hodge was simply a customer of Carno for whom Carno had executed two sell orders (Berkson Tr. 364). Whatever relationship Mr. Hodge may have had with Global Securities was not disclosed to Carno. The only contacts

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11 - SEC Brief, Page 34 footnote 26.

Carno had with Mr. Hodge involved the opening of Hodge's account and the two unsolicited sell orders. These contacts were entirely lawful. Accordingly, the record is devoid in any evidence to support the accusation levied by the SEC.

## D. No Agreement with Buzz

The SEC put great weight upon the fact that Mr. Nadino received a telephone call from a man named Buzz to support its contention that Carno and Nadino participated in a manipulation of Management Dynamics'stock. However, the record facts clearly demonstrate that Mr. Nadino did nothing before, during or after the Buzz telephone call that in any way violates the law.[12]

During this telephone conversation, Buzz first stated that he was interested in selling only five to ten thousand shares of Management Dynamics' stock, but later indicated that he had 100,000 shares that he was desirous of selling. Alerted to the fact that the stock of Management had never traded in that kind of volume, Mr. Nadino requested the certificate numbers. After Buzz furnished them, Mr. Nadino contacted the transfer agent. (Nadino Tr. 337). It is important to note that Mr. Nadino did not offer or sell the stock mentioned to him by Buzz. (Nadino Tr. 346-347).

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12 - Although timely objection was made upon the grounds that the substance of this conversation was inadmissible as hearsay, the District Court directed Mr. Nadino to testify.(Nadino Tr.333-334).

Upon cross-examination, Mr. Nadino testified that people often call him to test the size of the market in a particular stock before attempting to sell a large number of shares. (Nadino Tr. 342, 348). This practice is used by competing brokerage firms and is common to the securities industry (Nadino Tr. 348).

The individual that called Mr. Nadino identified himself as Buzz. He never identified himself as Pater Watson, (Nadino Tr. 343). Moreover, not only does Mr. Nadino not know Peter Watson but he does not know who he is, where he is, or whether he even exists. (Nadino Tr. 347). Therefore, there is not an iota of evidence to support the SEC's claim that Mr. Nadino spoke to Peter Watson with respect to Peter Watson's alleged attempts to sell Management Dynamics' stock.[13]

Most importantly, there is no evidence whatsoever to support the charge that Mr. Nadino offered to sell, offered for sale or sold any of the stock mentioned during the telephone conversation he had with Buzz.

E. No Agreement of Any Kind

The foregoing analysis manifests that neither Carno and Nadino were parties of any agreement with anyone of the defendants. The recorded facts clearly evidence that they

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13 - SEC Brief, page 12

never conspired with anyone to do anything with respect to the Management Dynamics stock. Consequently, the mere fact that the bulk of Management Dynamics stock sold by Carno and Nadino from September 29, 1972 to December 8, 1972 does not justify the District Court's conclusion that some type of manipulation in Management Dynamics' stock occurred.

## POINT VI

### THE DISTRICT COURT ERRED IN PRELIMINARILY ENJOINING CARNO AND NADINO

The District Court held that "when the SEC seeks injunctive relief the test to be applied is whether a proper showing of need has been established" (130). This was not the correct standard to apply in determining whether to grant or refuse the SEC's motion for a preliminary injunction. Consequently, the order of preliminary injunction is defective as a matter of law and should be vacated.

It is manifest by the statement "when the SEC seeks injunctive relief" that the District Court applied a less strict standard simply because the plaintiff is a governmental agency. By itself this kind of double standard constitutes reversible error. SEC v. Frank, 388 F.2d 486 (2d Cir.1968); Ring v. Authors League of America, 186 F.2d 637 (2d Cir.1951); SEC v. Harwyn Industries Corporation, 326 F.Supp. 943 (S.D.N.Y. 1971).

It is important to note that the test articulated by the District Court is insufficient for a more important reason. This reason is that the reduced standard employed by the District Court for the SEC contravenes the recently reaffirmed

standards for adjudging the applicability of a preliminary injunction.

As Judge Friendly stated in Missouri Portland Cement Co. v. Cargill, Inc., 498 F.2d 851 (2d Cir., June 10, 1974), quoting from Sonesta International Hotels Corp. v. Wellington Associates, 493 F.2d 247, 250 (2d Cir., 1973), there are two standards governing the issuance of a preliminary injunction in case arising under the securities laws:

> "The settled rule is that a preliminary injunction should only issue upon a clear showing of either (1) probability of success on the merits and possible irreparable injury or (2) sufficiently serious questions going to the merits as to make them a fair ground for litigation and a balance of hardships tipping decidely toward the party requesting the preliminary relief." (Emphasis in original) 498 F.2d at 866

The substantiality of the claimed violations of the securities laws allegedly committed by Carno and Nadino are entirely insufficient to meet any one of these requirements.

A. Absence of Possible Irreparable Injury

It is axiomatic that because a preliminary injunction is drastic it will not be granted unless the plaintiff can make a clear showing of probable success. Dopp v. Franklin National Bank, supra; Intercontinental Container Transport Corp. v. New York Shipping Association, 426 F.2d 884,887 (2d Cir.1970);

Checker Motors Corp. v. Chrysler Corp., 405 F.2d 319, 323 (2d Cir.) cert.den., 394 U.S. 999 (1969). On the findings of fact set forth in the District Court's opinion, Judge Carter was not justified in concluding that the SEC made the requested showing of probable success.

To make the requested showing of probable success, the SEC is required to prove that there is sufficient substance to their allegations both in law and in fact. The requested showing must be made to warrant an examination of the other requirements necessary to grant a preliminary injunction. Gulf & Western Industries, Inc. v. Great Atlantic & Pacific Tea Company, Inc., 476 F.2d 687, 693 (2d Cir. 1973).

An examination of the record reveals that the District Court erred in concluding that Carno and Nadino submitted fictitious quotations for Management Dynamics stock. The record further reveals that all purchases and sales of Management Dynamics stock qualify for a dealer's exemption from the registration provisions of Section 5 of the Securities Act except for the two sell orders executed for Samuel Hodge and both of these qualify for a broker's exemption from Section 5. Finally, the record reveals that the SEC failed to come forward with sufficient proof to warrant the conclusion that violations of the anti-fraud provisions were committed

by Carno and Nadino.

By reason of the foregoing, it is painfully clear that the SEC failed to make a clear showing of probability of success on the merits. Consequently, the preliminary injunction was improvidently granted.

B. Absence of Possible Irreparable Injury

A fair reading of the District Court's opinion discloses that there is no finding that any one would sustain irreparable injury if the preliminary injunction was not granted. It is well settled that, absent a showing of irreparable injury of some kind, no preliminary injunction should be granted. Missouri Portland Cement Co. v. Cargill, Inc., supra; Sonesta International Hotels Corp. v. Wellington Associates, supra; Gulf & Western Industries, Inc. v. The Great Atlantic and Pacific Tea Co., Inc., supra; Checkers Motors Corporation v. Chrysler Motors Corp., 405 F.2d 319 (2d Cir.) cert.den. 394 U.S. 999 (1969); Foundry Services, Inc. v. Beneflux Corporation, 206 F.2d 214 (2d Cir. 1953); Slade v. Shearson Hammill & Co., Inc., 356 F.Supp. 304 (S.D.N.Y. 1973).

The District Court's conclusion that all the SEC need to do is make a showing of need falls far short of the necessary finding of possible irreparable injury. A necessary

element of finding possible irreparable injury is evidence of past violations by Carno and Nadino of such a magnitude as to create a "reasonable likelihood" that future violations would be committed if a preliminary injunction did not issue. SEC v. Shapiro, 494 F. 2d. 1301, 1308 (2d. Cir. 1974); Glen-Arden Commodities, Inc. v. Constantino, 493 F. 2d 1027, 1035-1036 (2d. Cir., 1974); SEC v. Manor Nursing, 458 F. 2d 1082, 1100 (2d. Cir.,1972); Robert W. Stark, Inc. v. New York Stock Exchange, 466 F. 2d 743, 744 (2d. Cir. 1972). However, since there were no violations committed by Carno and Nadino the District Court could not properly conclude that a reasonable likelihood existed that future violations would be committed.

Although the SEC is correct in stating that Carno and Nadino have the burden of demonstrating that the District Court abused its discretion in granting preliminary injunction, the standard employed by the District Court was so inaccurate that it constituted a clear abuse of discretion. This Court recently held in Glen-Arden Commodities, Inc. v. Constantino, supra, at 1035-1036, that the SEC has the burden of showing probable success on the merits and possible irreparable injury before a preliminary injunction should be granted. Therefore the District Court's granting of the preliminary injunction by means of a lesser standard than that which is

appropriate in these circumstances constitutes a clear abuse of discretion warranting a reversal of the order of permanent injunction.

Finally, it is important to note that the record facts reveal a total absence of serious questions going to the merits as to make them a fair ground for litigation. Moreover, the record facts reveal that the balance of hardship tips decidedly toward vacating the order of preliminary injunction since the ramifications of the preliminary injunction so severely affect Carno and Nadino as to make it unjust to allow the preliminary injunction to stand.

In view of the SEC's failure to make a clear showing of probable success on the merits and possible irreparable injury Carno and Nadino respectfully submit that the preliminary injunction is defective as a matter of law and should be vacated. Glen-Arden Commodities, Inc. v. Constantino, supra; Missouri Portland Cement Co. v. Cargill, Inc., supra; Sonesta International Hotels Corp. v. Wellington Associates, supra; Gulf & Western Industries, Inc. v. The Great Atlantic and Pacific Tea Co., Inc., supra; SEC v. Shapiro, supra; SEC v. Manor Nursing, supra; and SEC v. Culpepper, 270 F. 2d 241, 249, (2d. Cir. 1959).

## CONCLUSION

The evidence does not support the SEC contention that it is entitled to a preliminary injunction

against Carno and Nadino. The record facts demonstrate that the SEC failed to show that it has evidence to sustain the claimed violations of a) Section 5 of the Securities Exchange Act of 1933; b) Section 17(a) of the Securities Exchange Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, or c) Rule 15c2-11 promulgated by the Securities Exchange Commission. Therefore, it is painfully clear that the preliminary injunction against Carno and Nadino was improvidently granted and it should be vacated.

Respectfully submitted,

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RICHARD M. KRAVER,
Of Counsel

US COURT OF APPEALS: SECOND CIRCUIT

Index No.

SEC,

Plaintiff-Respondent,

against

MANAGEMENT DYNAMICS, INC., et al

Defendants.

Affidavit of Personal Service

STATE OF NEW YORK, COUNTY OF NEW YORK ss.:

I, Victor Ortega, being duly sworn,

deposes and says that deponent is not a party to the action, is over 18 years of age and resides at

1027 Avenue St. John, Bronx, New York

That on the 25th day of October 1974 at *

deponent served the annexed Reply Brief upon

*

the in this action by delivering a true copy thereof to said individual personally. Deponent knew the person so served to be the person mentioned and described in said papers as the Attorney(s) herein,

Victor Ortega

Print name beneath signature

VICTOR ORTEGA

Sworn to before me, this 25th day of Ocott October 19 74

Robert T. Brin

ROBERT T. BRIN
NOTARY PUBLIC, STATE OF NEW YORK
NO. 31 - 0418950
QUALIFIED IN NEW YORK COUNTY
COMMISSION EXPIRES MARCH 30, 1975

* Borden & Ball- 345 Park Ave., New York
* Daniel Beescher- 230 Park Ave., New York
* Lipkin, Gisare, & Held- 225 Broadway, New York

A 201 Affidavit of Service by Mail G LUTZ APPELLATE PRINTERS, INC.

US COURT OF APPEALS: SECOND CIRCUIT

SEC,
Plaintiff-Respondent

against

MANAGEMENT DYNAMICS, INC., et al
Defendants.

Index No.

Affidavit of Service by Mail

STATE OF NEW YORK, COUNTY OF NEW YORK ss.:

I, Karen Giles, being duly sworn,

deposes and says that deponent is not a party to the action, is over 18 years of age and resides at 1013 East 180th Street, Bronx, New York

That upon the 25th day of October 1974, deponent served the annexed Reply Brief upon Lawrence E. Nerhein, attorney(s) for in this action, at 500 No, Capitol Street, Wash. DC 20549 the address designated by said attorney(s) for that purpose by depositing a true copy of same, enclosed in a postpaid properly addressed wrapper in a Post Office Official Depository under the exclusive care and custody of the United States Post Office Department, within the State of New York.

Sworn to before me, this 25th day of October 1974

Karen Giles

Print name beneath signature

KAREN GILES

Robert T. Brin

ROBERT T. BRIN
NOTARY PUBLIC, STATE OF NEW YORK
NO. 31 - 0478950
QUALIFIED IN NEW YORK COUNTY
COMMISSION EXPIRES MARCH 30, 1975